BUSINESS LAW SECTION

Standing Committee on Cyberspace Law

Trademark Licensing - Watch Out for the Minefields

By Scott M. Hervey[*]

The trademark license; the concept appears so simple. One party has a commercially viable trademark; a second party has a product they wish to brand with the trademark in order to increase the sales of the product as well as its selling price. In exchange for the first party letting the second party use the trademark, the second party pays the first party. If only it were this easy.

A trademark license can be a complex arrangement. Even in the simplest arrangement, issues can lurk in the shadows waiting to spring on the unaware practitioner. There are a number of issues which should be considered when looking at the terms of a license in order to make sure that it does not create undue problems for your client.

The Grant Clause. First, make sure the grant clause spells out exactly what is being licensed. The parties should consider whether the licensed trademark includes any logos or has certain color requirements. Also consider whether the licensee can use the licensed mark in such a way so that it is linked with its own marks, or whether the license covers only a specific mark or includes new versions of the mark that may be created in the future.

The licensor should make certain that it is satisfied with how the license agreement addresses the products and services the licensee will brand with the licensed mark. Sometimes it is appropriate to narrowly tailor the type of products the licensee may sell under the mark. For example, a mark that is used for children’s products may be tainted if used in association with certain other products.

Next, be sure the license spells out whether the licensor is granting an exclusive or a non-exclusive license. An exclusive license precludes all parties, except for the licensee but including the licensor, from using the licensed mark for the goods or services covered by the license. Because of the extreme nature of the grant, the licensor should be sure that an exclusive license is appropriate for the situation and that the licensee is capable of exploiting the license. The licensor should narrowly tailor the grant and make sure that the exclusive license is no broader than necessary. Exclusivity can be broken down or tailored as creativity and ingenuity allow. Exclusivity can be limited in numerous ways, including, for example, jurisdictions, product lines, channels of trade and combinations thereof.

Under a non-exclusive license, the licensee still enjoys the right to use the mark for the goods or services covered by the license. However, the licensor also enjoys the same right, and can license this right to others who may compete with the licensee. To prevent this, the licensee may want to consider a sole license. Under a sole license the licensee’s right to use the mark in connection with the goods or services covered by the license is exclusive with the exception of the licensor.

Licensors should also be aware of the territory covered by the license agreement. If the license agreement fails to make restrictions, the licensee may have a world wide right. For various reasons, a licensor may not want to give the licensee such a broad right. For example, if the licensor has secured trademark registrations in the U.S., Canada and the European Union, but the licensee uses the mark in Japan and is sued for infringement, the licensee may have a claim against the licensor depending on the representations and warranties the licensor made in the license agreement.

Quality Control. The licensor is required to control the quality of the goods or services offered by the licensee under the trademark. A trademark license agreement that does not contain quality control provisions, or where no quality control has been exercised is considered a “naked license” and may result in the abandonment of the licensor’s right in the trademark.

There are varying degrees of control a licensor may impose. The licensor may rely on the licensee to control quality. Usually, where the licensor has previous knowledge of the quality of the licensee's goods, and where the licensee requires the licensee to maintain the level of quality, and where the licensor has an adequate basis for reliance, this type of quality control will ordinarily be upheld.

A licensor may also exercise direct control. Direct control includes situations, where the license agreement contains provisions for direct control by the licensor over the goods or services supplied under the mark. Direct control can include where the license agreement requires the licensee to purchase the products or their key ingredients from certain approved vendors, requires adherence to a production method, and the like.

However, the licensor must walk a fine line when setting up standards for direct control in order to avoid being deemed a franchisor. If the license agreement provides for "significant" levels of control, a court may recast the license agreement as a franchise agreement and subject the licensor to stringent state and federal franchise regulations.

There are a number of other clauses that should find their way into any license agreement; each with its own twists and turns. Careful thought and preparation when dealing with a trademark license agreement can help the practitioner avoid the hidden traps and minefields and aid in drafting a clear agreement which benefits all parties involved.

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